

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201122014**

Release Date: 6/3/2011

Index Number: 856.01-00

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:FIP:B01

PLR-150476-10

Date:

February 17, 2011

In Re:

Legend:

Taxpayer =

State =

a =

Partnership =

b =

c =

d =

e =

f =

g =

h =

i =

Dear

This is in response to your letter dated March 3, 2010, and subsequent correspondence dated October 21, 2010, November 18, 2010 and December 17, 2010, submitted on behalf of Taxpayer requesting a ruling that certain income from Tax Loans (as defined below) qualifies as interest on obligations secured by mortgages on real property or on interests in real property for purposes of section 856(c)(3)(B) and as interest under section 856(c)(2)(B) of the Internal Revenue Code of 1986, as amended (the "Code").

FACTS

Taxpayer is a State corporation which intends to either elect to be treated as a real estate investment trust (a "REIT") or merge with an existing corporation that will elect to be treated as a REIT for federal income tax purposes. Taxpayer is in the business of making advances for the payment of real property taxes in the form of Tax Loans, as described below. Currently, Taxpayer has an a percent interest in Partnership which holds Tax Loans through an entity that is disregarded for federal income tax purposes. Upon electing to qualify as a REIT, Taxpayer or its successor will acquire a greater interest in Partnership and Partnership will remain in existence and will serve as its operating partnership.

On December 3, 2010, Taxpayer received a private letter ruling, which held that Tax Loans qualify as real estate assets within the meaning of section 856(c)(5)(B) of the Code. Taxpayer currently requests a ruling that income denominated as "interest income" from those Tax Loans qualifies as interest on obligations secured by mortgages on real property or interests in real property for purposes of section 856(c)(2) and as interest for purposes of section 856(c)(3).

Counties, municipalities, school districts, and other local divisions of state governments (each, a "Tax Unit") generally impose real property taxes on real property located within their jurisdictions in an amount from b percent to c percent of the assessed value of the real property. These Tax Units often depend on real property taxes to provide their principal source of funding.

The principal mechanism available to a Tax Unit for collecting real property taxes and related interest, penalties and fees (the "Tax Liability") is a tax lien. Generally, if the tax is not paid by a due date, a statutory lien is created in favor of the Tax Unit on the real property that is senior in priority (a "Super Priority Lien") to a lien held by the first mortgage holder.

In some states, the owner of real property (the "Owner") can resolve a Tax Liability with the assistance of a third party, such as Taxpayer that advances funds to the Tax Unit on behalf of the Owner in the amount of the Tax Liability ("Tax Loan"). The Owner gradually repays the Tax Loan to Taxpayer with interest.

An Owner can apply for a Tax Loan from Taxpayer by filling out an application and supplying materials that are similar to those required to apply for a typical real estate loan. If Taxpayer approves the Tax Loan, the Owner signs and delivers a note (a "Note") to Taxpayer reflecting the amount of the Tax Loan. The Note provides for a fixed rate of interest, generally from d percent to e percent, and matures at the end of a fixed period, generally f to g years. Taxpayer has represented that this amount is compensation for the use or forbearance of money. The Owner also signs a deed of trust (a "Deed of Trust") and an affidavit authorizing the transfer of a lien on the real property from the Tax Unit.

Taxpayer then pays the amount of the Tax Liability to the Tax Unit on behalf of the Owner. As security, the Tax Unit signs a document transferring its Super Priority Lien on the real property to Taxpayer (the "Tax Lien Transfer"). The Deed of Trust and Tax Lien Transfer are then recorded in the local land records.

Taxpayer represents that there are many safeguards in place to ensure that the Tax Loan is adequately secured by real property. First, state law provides that the Tax Loan has priority over any mortgage loans previously recorded against the real property, including first lien mortgages. Second, Taxpayer cannot make a Tax Loan in an amount exceeding the Tax Liability and related closing costs, such as inspections, credit reports, legal fees, courier fees, inspection fees, origination fees, etc. ("Related Costs"). The entire amount of the Tax Loan must be used to pay the Tax Liability and Related Costs. Third, Taxpayer gathers information about the Owner and the value and condition of the real property, to determine whether the real property will provide sufficient collateral for the Tax Loan. Fourth, Taxpayer only makes Tax Loans when certain underwriting criteria are satisfied; such criteria include the Owner's credit worthiness and the real property's value and condition. Taxpayer generally avoids making a Tax Loan in excess of h percent of the appraised value of the real property. Taxpayer also represents that it will never make a Tax Loan in excess of i percent of the appraised value of the real property. Finally, the Super Priority Lien on the real property enables Taxpayer to foreclose upon the real property.

LAW AND ANALYSIS

To qualify as a REIT, an entity must derive at least 75 percent of its gross income from sources listed in section 856(c)(3) and at least 95 percent of its gross income from sources listed in section 856(c)(2). Among the sources of income that qualify under section 856(c)(3) is interest on obligations secured by mortgages on real property or on interests in real property. Among the sources of income that qualify under section 856(c)(2) is interest.

Section 856(f) of the Code provides, in part, that the term "interest" excludes any amount received or accrued, directly or indirectly, if the determination of such amount depends in whole or in part, on the income or profits of any person except that any

amount so received or accrued will not be excluded from the term “interest” solely by reason of being based on a fixed percentage or percentage of receipts or sales.

Section 1.856-5(c)(1) of the Income Tax Regulations (the “Regulations”) provides that where a mortgage covers both real and other property an apportionment of the interest income must be made for purposes of the 75-percent income test under section 856(c)(3). The Regulations provide that if the loan value of the real property is equal to or exceeds the amount of the loan, then the entire interest income shall be apportioned to the real property. If the amount of the loan exceeds the loan value of the real property, then the interest income apportioned to the real property is an amount equal to the interest income multiplied by a fraction, the numerator of which is the loan value of the real property, and the denominator of which is the amount of the loan. The interest income apportioned to the other property is an amount equal to the excess of the total interest income over the interest income apportioned to the real property.

Section 1.856-5(c)(2) provides, in part, that the loan value of the real property is the fair market value of the property, determined as of the date on which the commitment by the trust to make the loan becomes binding on the trust. However, in the case of a construction loan or other loan made for purposes of improving or developing real property, the loan value of the real property is the fair market value of the land plus the reasonably estimated cost of the improvements or developments (other than personal property) which will secure the loan and which are to be constructed from the loan proceeds of the loan. The fair market value of the land and the reasonably estimated cost of improvements or developments shall be determined as of the date on which a commitment to make the loan becomes binding on the trust.

Section 1.856-3(g) provides that if a REIT is a partner in a partnership, the REIT will be considered to own the partnership's real estate assets in the same proportion as its capital interest in the partnership.

In the instant case, Taxpayer, or a successor corporation, through Partnership and its disregarded entity, will hold Tax Loans that are secured by a Super Priority Lien on the Owners' real property. Taxpayer has previously received a private letter ruling in which concluded that the Tax Loans qualified as real estate assets within the meaning of sections 856(c)(5)(B) and 1.856-3(b)(1). Taxpayer has also represented that the interest income constitutes compensation for the use or forbearance of money and that the interest earned on Tax Loans is a fixed rate.

CONCLUSION

Based on the facts as represented, we rule that interest income earned by Taxpayer from a Tax Loan qualifies as interest on obligations secured by mortgages on real property or on interests in real property under section 856(c)(3)(B) to the extent that the Tax Loan is secured by real property, the value of which is at least equal the total

amount of the Tax Loan, provided that the amount of such income does not depend in whole or in part on the income or profits of any person, except as provided in section 856(f). In addition, interest income earned by Taxpayer from Tax Loans qualifies as interest under section 856(c)(2)(B) provided that the amount of such income does not depend in whole or in part on the income or profits of any person, except as provided in section 856(f).

Except as specifically ruled upon above, we express no opinion on the federal tax consequences of the transactions described above under any other provisions of the Code and Regulations. Additionally, we express no opinion on the valuation of any real property securing a Tax Loan and whether any Tax Loan is fully secured by real property. In particular, no opinion is expressed concerning whether Taxpayer otherwise qualifies as a REIT under part II of subchapter M of Chapter 1 of the Code.

This ruling is directed only to the taxpayer requesting it. Taxpayer should attach a copy of this ruling to each tax return to which it applies. Section 6110(k)(3) of the Code provides that this ruling may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Richard LaFalce

Richard LaFalce

Assistant to the Branch Chief, Branch 1

Office of Associate Chief Counsel

(Financial Institutions & Products)